Bundled Transactions – Telecommunications and Related Services

Sales & Use tax notice #04-33

Public Chapter 782 (2004)

Effective July 1, 2004, Public Chapter 782, Acts of 2004, amends Tenn. Code Ann. Title 67, Chapter 6 relative to telecommunications services.

New Definition: Among the new definitions in Public Chapter 782 is a definition of a bundled transaction. The new definition can be found in Tenn. Code Ann. Section 67-6-539 and applies only to Internet access, ancillary services, and telecommunications.

> For the purposes of Section 67-6-539, a "**Bundled Transaction**" means the retail sale of otherwise distinct and identifiable products for one non-itemized price that does not vary and is not negotiable based on the selection of the products made by the purchaser.

Example 1: A telephone company sells at retail a package of services for one flat monthly amount of $25. The deal includes local telephone service, Internet access, and four ancillary services: call waiting, caller identification, call forwarding, and voice mail services. The purchaser cannot pick or choose among the different services that are to be included in the bundle. Thus, this is a bundled transaction.

This transaction is for a retail sale of more than one distinct product and the sales price of each of the products was not itemized either in the invoicing given to the purchaser or in the pricing of the products to the purchaser.

Taxation of Bundled Transactions: Prior to Public Chapter 782, if a non-taxable product, such as Internet access, was bundled with taxable products, such as local telephone service and ancillary services, the single non-itemized price ($25 in example 1) would be subject to tax. To retain its non-taxable character, the non-taxable service would have to be separately itemized, and the customer must have the option of not purchasing the non-taxable product.

Because of recent changes in methods of billing customers for services, the special tax rates for ancillary and telecommunication services and the change in the tax treatment of Internet access to a non-taxable service, Public Chapter 782 provides for new procedures for collecting tax on bundled transactions of telecommunications, ancillary services, and Internet access.

1) If the bundled transaction is for taxable telecommunication or ancillary services and non-taxable Internet access, tax will be calculated using the total price for the bundled products, unless the seller can document from the seller's books and records the portion of the sales price that is for the non-taxable Internet access.

Sellers, who as a part of their regular business practices account separately in their books and records for the sales of the different products in a bundle, should collect tax only on the sales price apportioned to the taxable products in the bundled transaction. Sellers must use a reasonable method of apportionment. Sellers that do not separately account for bundled products in their books and records **must** collect tax on the single non-itemized price.

The new law also provides for a method to deal with bundles when the telecommunication or ancillary services are taxed at different rates.

Tax Rates
1) Intrastate 7% state, 2.5% local
2) Business interstate & international 7.5% state, no local
3) Residential interstate & international 7% state, 1.5% local
4) Ancillary service 7% state, 2.5% local

2) If the bundled transaction is for the purchase of telecommunication or ancillary services that are subject to different state or local tax rates, tax will be calculated using the total price at the higher combined state and local tax rate unless the seller can document from the seller's books and records the portion of the sales price subject to the lower tax rates.

Example 2: A mobile telephone company sells at retail to residential customers a bundle of services for a $45 flat monthly amount. The deal includes a total of 700 minutes for both intrastate and interstate calls, and voice mail services. The company accounts for the sales of each of these products separately in its books and records in the following manner: intrastate sales $20, interstate sales $20 and voice mail $5.

In example 2, tax should be calculated on the apportioned price of the bundled transaction in the following manner:

Intrastate	$20 x 9.5% = 1.90	
Residential interstate	$20 x 8.5% = 1.70	
Ancillary/voice mail	$5 x 9.5% = .48	
Tax Due		$4.08

If the bundled services are not accounted for in the seller's books and records separately, tax must be calculated on the single non-itemized price ($45) at the higher tax rate measured by combining the state and local tax rates together. In example 2, the tax due would be calculated using the state rate of 7% and local rate of 2.5% since the combination of these rates equals the higher rate applicable to one of the services included in the bundle.

3) Tenn. Code Ann. Section 67-6-221 provides 4% of the 7.5% state tax collected on business interstate and international telecommunications will be distributed to the Telecommunications Ad Valorem Tax Reduction Fund.

Any seller that either: 1) collects tax on the single non-itemized price for a bundled transaction or 2) taxes it at a higher combined state and local tax rate because the products are not separately accounted for in its books and records, must contact the Department of Revenue for approval to report a portion of the tax collected as funds that should be distributed to the Telecommunications Ad Valorem Tax Reduction Fund.

Effective Date: These new procedures apply to bills issued to customers that are dated on or after July 1, 2004, for charges that were not previously billed. The procedures **do not** apply to transactions where services other than telecommunications, ancillary services and Internet access or tangible personal property are also included in the bundle of products. Such transactions will be subject to tax on the single non-itemized price, and the seller **does not** have the option to apportion the amount subject to tax based on its books and records.

Sellers must continue to separately indicate on invoices or other sales documents given to the customer the amount of tax the customers are paying. Tennessee Rules and Regulations 1320-5-1-.90(1).

If you have any questions about this notice, you may contact the department. Tennessee residents outside the Nashville calling area may call our statewide toll-free number at (800) 342-1003. Callers from Nashville or out-of-state may dial (615) 253-0600. You can access additional formation on our Web site at www.Tennessee.gov/revenue.

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